Detail Commercial Solicitors

SOURCES OF CAPITAL MARKET FINANCING FOR AGRICULTURE IN NIGERIA

INTRODUCTION

According to the Food and Agricultural Organisation of the United Nations (FAO), agriculture remains one of the largest sectors of the Nigerian economy and employs two-thirds of the entire labour force. However, a major factor that has stifled the growth of the sector is access to financing for investment.

Taking into consideration the long-term and capital-intensive nature of the agriculture sector, reliance on predominantly short-term borrowing from the banks is inadequate. As such, the Nigerian capital market provides opportunities for businesses in the sector to access long-term financing under the supervision of the apex regulator, the Securities and Exchange Commission (SEC).

This article explores the sources through which the capital market can help to bridge the funding gap in the Nigerian agriculture sector.

a) Corporate Bonds

Corporate bonds are debt instruments which may be issued by corporate entities to finance projects and their operations. Such offerings may be made through a private placement—which is an issuance made to select investors by a public limited liability company or via a public issuance made to the investing public. Both private placements and public issuances require the approval of SEC.

The Pension Fund Administrators (PFAs) are major participants in the bonds market. According to the Fourth Quarter Report, 2020, by the National Pension Commission (PenCom), Nigeria has approximately N12.31 trillion pension asset under management of the PFAs, under the country's contributory pension scheme. The funds may be invested in corporate bonds that satisfy the requirements under the amended Regulation on Investment of Pension Fund Assets, 2019. Principal amongst the requirements of this regulation is that primary market investments in bonds, debentures, and other debt instruments

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(excluding commercial papers) must (i) be issued by corporate entities through public offering or private placement arrangements approved by SEC, and (ii) have a minimum "A" rating by two rating agents registered with SEC. 20% investment cap is allowed for "B" rated assets.

b) Project Specific Bonds

Project specific bonds refer to bonds that are tied to named infrastructure projects with the repayment plans tied to the cashflows from such projects.

Project-specific bonds will typically involve off-balance sheet funding. In such an instance, the investors' key concern or consideration would not be the balance sheet of the agricultural company seeking investment but its ability to guarantee that its estimated cashflows would be sufficient for the repayment of the bondholders. This concern may be satisfied by the provision of long-term offtake contracts with distributors of the company's products and the provision of security on its assets, or third-party guarantees as a further means of investor protection.

c) Crowdfunding

Crowdfunding is the use of small amounts of capital from many individuals or organizations to fund projects or businesses through an online crowdfunding platform. It is a prevalent means of raising capital by micro, small and medium enterprises

(MSME) in the agriculture sector. Through crowdfunding, the pool of investors is expanded beyond the traditional circle of owners, relatives, and venture capitalists.

In Nigeria, crowdfunding is regulated under the SEC Rules and Regulations 2013 as amended in January 2021 (the Crowdfunding Rules). According to the Crowdfunding Rules, MSMEs incorporated as companies in Nigeria with a minimum of two-year operating track record are eligible to raise funds through a Crowdfunding Portal in exchange for investment instruments. However, an exception is allowed for MSMEs with less than two years operating track record provided such MSMEs have a strong technical partner or core investor that possesses a minimum of a two-year operating track record.

Whereas the general rule is that securities to be issued to the public in Nigeria are to be registered with SEC, securities raised through crowdfunding are exempted from registration with the apex capital market regulator.

It is also useful to note that MSMEs may raise an aggregate amount of N100 million within a funding period. The crowdfunding rules also creates a Commodities Investment Platforms (CIP), which is a framework that allows digital platforms connecting investors to specific agricultural or commodities projects and corporates to raise a maximum of N1 billion for agricultural or commodities projects.

d) Securitization of Future Cash Flows

Agriculture-focused companies may also raise funds through the securitization of their future cashflows. Securitization is the process of converting eligible assets, such as cash flows, into securities. It entails the originator selling a portfolio of assets to a special purpose vehicle – the issuer, who finances the purchase by packaging the cash flows from these assets as tradable financial instruments to be sold to investors.

Securitization in Nigeria is regulated by SEC under the Rules on Securitization, 2015. However, there is a pending Nigerian Securitization Bill before the House of Representatives, which is aimed at regulating securitization practice in the country. The bill contains provisions for securitization of transactions and issuance of asset-backed securities to promote the availability of credit at affordable rates and long-term funding in Nigeria's capital market.

Like project-specific bonds, a key consideration for investors when a securitization will be undertaken is the sufficiency of the future cashflows. In this regard, factors to be considered includes the economic potential of agricultural produce and the presence of long-term contracts.

e) Central Bank of Nigeria (CBN)'s Differentiated Cash Reserve Requirement (DCRR)

In a bid to increase the flow of credit into the real sector of the economy to consolidate and sustain economic recovery, the CBN in 2018 introduced the DCRR. Under this framework, Deposit Money Banks (DMB) interested in financing new and existing projects in manufacturing and agriculture may request funds from their Cash Reserve Requirement (CRR) to finance such projects, subject to the approval of the CBN. Additionally, the CRR can also be applied to bonds within the DCRR framework.

The bonds contemplated under the DCRR are mainly corporate bonds for new and expanding projects in agriculture, manufacturing, and other related sectors approved by the CBN. The key attraction is the interest rate, which is pegged strictly at 9%. This provides financing at a rate lower than what is typically obtainable in other bonds issued outside the DCRR framework. The CRR is domiciled with the CBN and the repayment is done back to the central bank.

The maximum amount a bank can withdraw under the DCRR is N10 billion, with seven years as the repayment period. It is not clear whether the fund raised through the DCRR should be exclusively used to purchase bonds from corporates or it could also be used as a guarantee. It would be necessary to clarify this when structuring a transaction under the framework.

Potential Hurdles

Some of the potential risks for agricultural financing in Nigeria include the following.

a) **Exposure to Natural Risks**: In the agriculture sector, output is largely determined by natural factors, which are naturally occurring physical phenomena caused either by rapid or slow onset events. The events can be geophysical, such as earthquakes, landslides, tsunamis, and volcanic activity; hydrological, such as avalanches and floods; climatological, including extreme temperatures, drought, and wildfires; meteorological, like cyclones and storms/wave surges; or biological, such as disease epidemics and insect pest and animal plagues. Such risks can discourage capital market investment in agriculture.

b) **Lack of Proper Corporate Set Up:** Being a largely primary sector, most Nigerian agricultural outfits do not possess proper corporate identity that would enable their proprietors to have access to the capital market to raise fund. Most agricultural enterprises in Nigeria are made up of family units engaging in subsistence farming and, thus, are not registered with the Corporate Affairs Commission (CAC).

The presence of more corporate structures in the industry will give confidence to financiers, opening up the agribusinesses to more funding opportunities.

c) **Absence of Long-Term Offtake Contracts:** An offtake contract is an agreement between a producer and a buyer to purchase or sell portions of the impending produce of the producer. The absence of offtake contracts for agricultural produce makes it difficult for producers to raise fund in the capital market for financing expansion of their projects or new equipment.

c) **Lack of Creditworthiness of Agricultural Companies:** Agricultural companies must surmount the huddle of creditworthiness in raising fund from the capital market. This is particularly important if they are to access the huge pension fund.

One way of scaling the hurdle is to have credit enhancement solutions, which will improve the rating of the securities to be issued in the capital market. Institutions like InfraCredit, whose mandate involves guaranteeing local currency bonds, and Nigeria Incentive Based Risk Sharing for Agricultural Lending (NISRAL) Plc, which is tasked with stimulating the flow of affordable finance into the agricultural sector, may be useful in developing structures to assist agribusinesses in accessing financing through the capital market.

Conclusion

The success of Nigeria's agriculture has been hindered by the inability of agribusinesses operating in the sector to access financing. Fortunately, the Nigerian capital market provides many opportunities for unlocking the required long-term financing to bridge the funding gap in the country's agriculture sector. To successfully access such financing, however, the financiers require the risks of investing in the sector to be mitigated to provide them comfort that their investments will generate returns.

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